REVIEW

LIEFMANN'S GRUNDSÄTZE DER VOLKSWIRTSCHAFTSLEHRE [1]

For over two decades there have been signs in Germany of an awakened interest in economic theory. Striking evidence of the momentum of this revival appears in the fact that the first edition of the first volume of Liefmann's Grundsätze (fifteen hundred copies he tells us) could be disposed of within three years amid the shattering events of war and revolution. This surprising sale of a large volume given wholly to theory might, however, be explained in part by the great claims which its author advances. Liefmann's hat is in the ring. He would supersede practically all preceding theory. His conception of economic life, he tells us, "is not only new, but separated by a whole world from the preceding one — is, one might say, almost a different science" (vol. ii, p. 603).

All previous theory is materialistic in that it thinks chiefly of the getting of quantities of material goods. It confuses productive technique with economic calculations and activity. It fails to analyze the fundamental economic factors, which are psychological. Even the Austrian theory, tho bringing in psychological considerations, places them on the materialistic background of the older economics. Psychological and realistic are the adjectives, Liefmann informs us, which best differentiate his system from others. But he also calls it dynamic (not using this term, however, as generally understood by economists), abstractly calculating (*abstrakt rechnend*) and individualistic.

Economic life consists of calculations of utility and cost. Whether as consumer or producer, we all aim at a maximum

[1] Robert Liefmann, Grundsätze der Volkswirtschaftslehre. Vol. i, Grundlagen der Wirtschaft, 2te neu bearbeitete Auflage, pp. xxiii, 708 (1920); vol. ii, Grundlagen des Tauschverkehrs, pp. xvi, 858 (1919).

yield (*Ertrag*) of utility in excess of or in proportion to cost. Cost is fundamentally labor pain-cost. *Ertrag*, Liefmann's darling concept, is usually spoken of by him as an excess over cost. He manages the quantitative comparison of what appear to be incommensurable subjective states, by describing the desire for utility as a lack, a pain (*Unlustgefühl*). Deduct from the pain of wanting a utility the *Unlustgefühl* of laboring to produce it, and you have your *Ertrag*. Now each of us distributes his costs (his labor) so as to secure the same *Ertrag* at the margin of each line of consumption and production. Out of such calculations of individuals arise the prices and incomes of the exchange economy (*Tauschwirtschaft*) which economic theory is to explain. Liefmann's system, therefore, is "individualistic" in its approach to the problems it seeks to solve.

Now what happens to Liefmann's psychological factors when our individuals enter the market? Labor pain-cost apparently drops out. The consumer may have income to spend which never cost him labor. Costs to him, therefore, can only be pecuniary costs. Obviously to the entrepreneur also costs appear mostly in terms of money. So in Liefmann's exposition we get pecuniary costs substituted for the fundamental labor pain-cost, with occasional references, however, to the latter, as "lying behind" the money costs. But *Ertrag* still continues to play its part in the exposition. It is now yield of utility in excess of or in proportion to pecuniary costs for the consumer, and money profits for the producer.

When we come to the explanation of the market value of commodities, we get an account of the factors on the side of demand which is quite in the vein of the Austrian theory which Liefmann professes to reject, except that marginal yield (*Grenzertrag*) takes the place of marginal utility (*Grenznutzen*). Now it may be argued that economic theory is not vitally concerned with a refined analysis of the consumer's or purchaser's states of mind. Grant the existence of a demand schedule as pictured by the curve now so familiar to the reader of English, American, and Italian publications, and the economist has all he needs so far as demand enters into his prob-

lem. But inasmuch as Liefmann professes to have made an important contribution at this point, we may stop to inquire whether his conception of *Ertrag* is really an improvement on the Austrian formulation. That the utility of an article may exceed what is paid for it, is not a new thought. This excess has even been given a name and has been the subject of vexatious controversy among economists. But it is not to be thought of as excess or surplus of utility over the money paid for it (or over the pain-cost back of the money), but as surplus of utility over the utility of other things purchasable at the same price. At the margin of consumption the surpluses vanish. The increment of utility got from any particular commodity is there equal to that of any other commodity within the particular consumer's horizon which may be bought with the same money. There is an equalization (*Ausgleichung*) of utilities, not of surpluses. The equalization of marginal surpluses (*Grenzerträge*) upon which Liefmann lays such solemn stress, is really the extinction of these surpluses.

On the side of the supply of commodities, *Ertrag* appears as pecuniary profit, excess of prices realized over the expenses of production and marketing. The money received may stand in the business man's mind for the utility of what he expects to get with it, and back of his expenses — pretty far back — may be the pain-cost of labor. But virtually Liefmann's system has passed out of its psychological phase into the realm of pecuniary calculations. An extreme nominalist, he regards money as nothing but the abstract unit of accounts. His theory, therefore, begins to assume the title of "abstract calculation." The quantity of any commodity placed on the market is determined by the search for profit (*Ertrag*) which acts in such manner in the competitive industries as to establish a marginal rate of profit. At this point Liefmann brings in some very effective criticism of a common tendency of German economists to speak of "normal or expected or average profit" instead of marginal profit, and to regard such profit as an element of cost.

There is in his exposition a commendable insistence on the connection of all prices in the calculations of both consumers

and producers. He professes, however, to be the first to reveal this connection fully and asserts that only in the case of commodities which have elements of cost in common has any connection been recognized by previous theory. This claim to originality cannot of course be allowed. It is no doubt true that from much of our economic literature a careless reader might get the impression that each commodity gets its price determined apart from the prices of other things. Indeed it is not easy to make the beginner in economics see the connection between prices and the existence of a system or systems of prices. But apart from the general recognition of alternative uses of factors of production, all modern theory also recognizes as determining the demand for any commodity the comparison of its utility with that of other commodities. The relation between prices appears most clearly in the expositions of the mathematical economists but it is necessarily implied, even when not explicitly stated, in the writings of other theorists.

Price is taken by Liefmann to be a monetary expression. He rejects the usual German definition of *Preis* as goods given in exchange, because this is part and parcel of the materialistic economics which he would exorcise. He appears not to perceive, however, that his theory of price, as he discusses it under the head of demand and supply, is a theory of *comparative* price only, that is of *value*, as that term is understood by the classical writers. To make it a complete theory of prices, it needs to be supplemented by a theory of the general price level. So far as the latter receives any attention from him, it is in the discussion of increase of money under the head of factors causing changes in prices. Increase of money, however, is considered side by side with factors affecting particular commodities and relative prices only. In this muddled way of explaining changes in the price level, Liefmann unfortunately does not stand alone among German writers.

His long drawn out description of the general mechanism of demand and supply contains occasional pages of admirably lucid exposition of established doctrine, but the reviewer fails

to discover any considerable contribution to our knowledge. When we come to the problem of what determines the prices entering into the entrepreneur's costs, it is not easy to follow a writer who rejects the tried instruments of economic analysis and disposes of long-standing problems as illusions. The whole doctrine of imputation of shares in the product to the different producers' goods and factors of production employed, Liefmann declares to be nonsense. His arguments against the possibility of imputation show little comprehension of modern theory. One argument quoted with approval from Dr. Mohrmann is a diverting play on words. The imputation theory, says this writer, assumes that in the product we get the *sum* of productive effects of the different factors of production. But production gives a *product* not a sum. It is multiplication not addition. Not bow *plus* arrow equals the bird the hunter kills, but bow *times* arrow equals bird! Entrepreneurs — to go on with his more general criticism — don't value separate producers' goods and factors of production. They just pay for them, and if their total costs fall below the total of prices realized on the sale of the products, there is *Ertrag*. Prices whether for goods or services or factors of production, are determined by bargaining power, by positions of competitive and monopolistic advantage and disadvantage. Capital is simply money cost to the entrepreneur. The gain of capital about which theorists have made such a pother, is very simple. It is the *Ertrag* or profit, and profit is no problem but just the goal and regulative principle of economic activity (Vol. ii, p. 602). It is the materialistic way of looking at things which creates the imaginary difficulties and puzzles of our traditional theory of distribution. Leave aside all thought of quantities of goods and technical services of factors of production, and view bargaining, purchase, and sale simply as turning about money prices (and money no material thing but just abstract unit of accounts), and everything is perfectly clear.

That is, it is perfectly clear to Professor Liefmann. Regarding the whole economic system in its monetary aspects, one might get the idea that all that is necessary to assure a gain to

capital is that the annual total of incomes spent for consumers' goods shall exceed the annual total of sums invested or re-invested. The proportion of this excess would account also for the rate of return (the average, not the marginal rate). But such a way of looking at the matter is too collectivistic, not individualistic enough even to occur to Liefmann. As it is, he leaves the matter of the existence and rate of capitalistic gain a mystery. He denies that there is any reason for regarding the existence of interest on capital as more of a problem than the payment of wages to the laborer or of rent to the land-owner. He remarks that if the rate of interest appears insufficient, funds will be spent for consumers' goods rather than devoted to investment, but this idea does not lure him on to the formulation of an abstinence or time-preference theory. Land in its money cost, we may note in passing, is capital to Liefmann, and land rent therefore is merged with income of capital.

He rejects the concept of distribution as materialistic and "sociological" (collectivistic) and announces that in future he will ignore discussions based on the idea of a division or distribution of the total product of society. What benighted theorists still consider under that title, Liefmann takes up under the head of *Einkommenslehre*. The idea of substituting a theory of incomes in place of one of distribution is not new to German literature, but was introduced by Philippovich some years ago in his *Grundriss der politischen Oekonomie*. In Liefmann's treatment, it falls easily into place in the pecuniary system of economics. Incomes (money incomes) arise as *Erträge* out of prices and the spending of incomes determines prices; and thus the circle is closed.

In place of the four traditional shares in distribution Liefmann considers a greater number of different kinds of income. For unskilled labor he sets forth a subsistence theory of wages. This, however, is not given the usual Malthusian basis but is supported by the curious argument that if wage-earners receive less than the money wages necessary to maintain their standard of living under the existing scale of prices, the consumers' goods which they are in the habit of pur-

chasing will fall in price and they will receive the same real income. *Per contra,* if they get higher wages, prices of consumers' goods will rise and they will be no better off. Comment seems unnecessary.

A formulation of economic theory in terms of money prices rather than in terms of value and of quantities of goods has some pedagogical advantages. The reviewer is disposed to regard it as the only feasible method of presenting the subject to the undergraduate. But in opposition to Liefmann, Cassel (*Theoretische Sozialökonomie,* 1918) and some of our American insurgents, it may be maintained that such a method is not complete and that to the seasoned theorist there is a gain in stripping off the monetary side of economic phenomena to get at fundamental factors, to think in terms of value rather than of price. Liefmann regards as one of the chief causes of error in the prevailing theory the persistent attempt to look behind the money veil. He makes the veil itself his theme. But if he had been less fascinated by it, he might not have overlooked so completely certain important problems. For instance, there is in these bulky volumes on the *Grundsätze* of economics no consideration of the character of the capitalistic method of production nor of the part played by capitalists in increasing or maintaining our productive apparatus. Altho he condemns the great work of Böhm-Bawerk *in toto* (vol. ii, p. 379) Liefmann might have profited by a careful study of it.

It is, of course, not easy to appraise Liefmann's theorizing in all its ramifications, even were it worth the effort. He writes an easy, fluent style, and the book contains interesting, passages. On the whole there is little reward for the pain-cost of going through its fifteen hundred pages. His understanding of the existing body of economic theory is astonishingly superficial. It is conceivable that a vigorous mind unhampered by what others have accomplished might attain to new and valuable ideas. But when a writer with all the prestige that goes in Germany with academic position puts forth such vast claims to originality as does Professor Liefmann, he should have informed himself conscientiously of what has already been done in the field. A long catalog could be made

of his misconceptions of other writers and of his reckless generalizations in regard to prevailing theoretical tendencies. Here and there in his many critical passages he scores a point, but often it is about matters largely verbal in character. Such criticism, of course, may have value. There are altogether too many careless expressions current in economic literature and their gradual elimination is much to be desired. But it is not easy to make exposition of complicated matters absolutely fool-proof and often it is not worth trying. "Life is not long enough for us to express, either in speech or in writing, all the limitations and reservations which we leave implicit in our statements." [1]

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[1] Henry Higgs in the Economic Journal, June, 1920, p. 244.